LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 7752 **NOTE PREPARED:** Apr 2, 2003
BILL NUMBER: SB 422 **BILL AMENDED:** Mar 31, 2003

SUBJECT: Tax Provisions.

FIRST AUTHOR: Sen. Borst **BILL STATUS:** As Passed - House
FIRST SPONSOR: Rep. Crawford

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State
X **DEDICATED**
FEDERAL

Summary of Legislation: (Amended) This bill corrects internal references. The bill separates the provisions related to the making of estimated payments for Adjusted Gross Income Tax from the provisions related to the making of estimated payments for the payment of Utility Receipts Tax. The bill also exempts any part of a Lottery prize won before July 1, 2002, but paid after July 1, 2002, from Adjusted Gross Income Tax.

The bill extends the Enterprise Zone Employee Deduction from Adjusted Gross Income Tax to employees of pass through entities located in an enterprise zone.

The bill adjusts the method of calculating the Utility Receipts Tax for a taxpayer with a taxable year that is not a calendar year. A taxpayer with a taxable year that is not a calendar year is required to file a final return for the taxpayer's liability under the Supplemental Net Income Tax by the fifteenth day of the fourth month after the close of the taxpayer's regular taxable year.

The bill provides a method for calculating Gross Income Tax due on the taxpayer's final return. The bill changes the method of calculating the tax due and specifies that a credit against Adjusted Gross Income Tax for Gross Income Tax paid for the year 2002 applies to Adjusted Gross Income Tax returns filed for any part of a taxable year that includes the year 2002.

Effective Date: (Amended) July 1, 2002 (retroactive); January 1, 2003 (retroactive); January 1, 2004.

Explanation of State Expenditures: The Department of State Revenue (DOR) will need to develop tax forms and procedures to reconcile the changes made due to P.L. 192-2002(ss) and this bill. This will be done within DOR's current budget.

Explanation of State Revenues: (Revised) This bill addresses some transitional and technical issues due to the restructuring of corporate income taxes contained in P.L. 192-2002(ss).

The bill specifies how taxpayers subject to the Utility Receipts Tax (URT) will make estimated payments and penalties associated with the underpayment of these taxes. It also adjusts the method to calculate URT for taxpayers who operate on a non-calendar tax year.

The bill clarifies that Lottery winnings from tickets bought before July 1, 2002, but paid after June 30, 2002, are exempt from income taxes. This technical clarification will have no fiscal impact.

The bill specifies how a non-calendar year taxpayer will estimate their 2002 tax liability for the Supplemental Net Income Tax (SNIT) and Gross Income Tax (GIT) which were repealed in P.L. 192-2002(ss) effective January 1, 2003. The Department may adopt procedures which would allow taxpayers to be granted an automatic extension of filing some returns due before April 16, 2003, to incorporate the changes proposed in this bill. The fiscal impact should be minor in that the tax that would be due will still be paid, but in the case of SNIT, the final liability might be slightly less or more depending on the taxpayer's business cycle.

Background: The bill will allow a taxpayer to calculate their final SNIT liability from actual adjusted gross income (AGI). Current law requires the taxpayer to estimate their AGI or report an AGI that might have been significantly higher on December 31 than it would be for the entire year. For example, a fiscal year farmer with tax year starting on September 1 might get paid for their crops in the fall and would have a high adjusted gross income amount because they have not purchased the seed or supplies until the spring. Under current law, they would be required to pay a significant amount of SNIT liability that would be more than what the full fiscal year amount would be. The bill allows a final SNIT return to be filed before the 15th day of the fourth month following the close of the taxpayer’s taxable year. This would resolve tax and estimated penalty problems when a non-calendar year taxpayer has income and expenses which are unevenly divided throughout two calendar years affected by the short taxable year established by P.L. 192-2002(ss).

The bill permits the taxpayer to take a credit for Gross Income Tax paid against the Adjusted Gross Income Tax (AGIT) for that part of the taxable year that occurs before January 1, 2003. The AGIT tax will be prorated based on the number of days in the fiscal year that are during 2002. The taxpayer will pay the greater of the GIT versus AGIT for 2002 and then will pay the AGIT at 8.5% prorated by the number of days in 2003.

Enterprise Zone Resident Employee Wage Deduction: The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who are Enterprise Zone (EZ) residents and are employed within an EZ. The revenue loss due to this bill could potentially total *at least* $260,000 to $300,000 annually beginning in FY 2005. The estimated revenue loss is based on employment data from pass through entities that have obtained other EZ tax incentives in recent years. It is important to note that the revenue loss would increase to the extent that additional pass through entities are operating in EZs and employing EZ residents, but do not obtain other EZ tax incentives. However, the number of remaining pass through entities operating in EZs and their EZ resident employment totals is unknown.

Background: The bill extends the EZ Resident Employee Wage Deduction to employees of pass through entities operating in EZs. Under current statute, this deduction may be accessed only by EZ residents who are employees of EZ businesses that are sole proprietorships or "C" corporations. The fiscal estimate is based on employment and employee wage data reported annually to the Indiana Department of Commerce by businesses obtaining EZ tax incentives. The estimate is based on report data for the period 1997 to 1999. Although annual report data from 2000 and 2001 is available, it is not utilized due to the frequency of reporting inaccuracies and incomplete reports. On average, 792 pass through entities operated in EZs from 1997 to 1999, with 222 employing EZ residents. Annual employment of EZ residents by these pass through entities averaged about 1,194 during the three-year period. The wages to these employees averaged about $18.1 M annually resulting in an employee average wage exceeding $15,000. Assuming a $7,500 deduction for each of these employees, the estimated annual tax impact averaged about $299,000 from 1997 to 1999. The estimated tax impact of the deduction assuming $7,500 per employee ranged from about $272,000 using the 1997 data to about $316,000 using the 1998 data. However, income tax return data for EZ resident employees of sole proprietorships and "C" corporations suggests that the average deduction is about $6,400. Based on the employment total from the IDOC reports, this would lead to a revenue loss of about $260,000.

Since this provision is effective beginning in tax year 2004, the fiscal impact would begin in FY 2005. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) Because the extension of the EZ Resident Employee Wage Deduction would serve to decrease taxable income, counties containing EZs and imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: Tom Conley, Department of State Revenue, 317-232-2107; Deanna J. Oware, Indiana Department of Commerce, Community Development Division, (317) 232-8917.

Fiscal Analyst: Diane Powers, 317-232-9853; Jim Landers, 317-232-9869.